

**STATE OF NORTH DAKOTA
BISMARCK, NORTH DAKOTA**

**REPORT OF EXAMINATION
OF
GREAT DIVIDE INSURANCE COMPANY
SCOTTSDALE, ARIZONA**

**AS OF
DECEMBER 31, 2002**

STATE OF NORTH DAKOTA
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

Great Divide Insurance Company

Scottsdale, Arizona

as of December 31, 2002, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto
set my hand and affixed my official seal at my
office in the City of Bismarck, this _____ day of
_____, 2004.

Douglas L. Holloway
Deputy Commissioner of Insurance

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Scottsdale, Arizona
March 29, 2004

Honorable Kevin McCarty
Chair, Financial Condition Committee
Subcommittee, NAIC
Director of Insurance Regulation
Florida Department of Financial Services
200 East Gaines Street, Room 101
Tallahassee, Florida 32399-0301

Honorable Sally McCarty
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Commissioner of Insurance
Indiana Department of Insurance
311 West Washington Street, Suite 300
Indianapolis, Indiana 46204-2787

Honorable John Morrison
Secretary, Western Zone
Commissioner
Montana Department of Insurance
840 Helena Avenue
Helena, Montana 59601

Honorable Jim Poolman
Vice President, NAIC
Commissioner of Insurance
North Dakota Department of Insurance
600 East Boulevard
Bismarck, ND 58505-0320

Dear Director and Commissioners:

Pursuant to your instructions and statutory requirements, a financial examination has been made of the books, records, and financial condition of

**Great Divide Insurance Company
Bismarck, North Dakota**

with administrative offices located at 7273 East Butherus Drive, Scottsdale, Arizona.

Great Divide Insurance Company, hereinafter referred to as the "Company", was last examined as of December 31, 1997, by the North Dakota Insurance Department.

SCOPE OF EXAMINATION

This examination was a financial condition examination conducted in accordance with N.D. Cent. Code § 26.1-03-19.3 and observed guidelines and procedures contained in the NAIC *Financial Condition Examiners Handbook*. The examination was conducted to determine the Company's financial condition, its compliance with statutes, and to review the corporate affairs and insurance operations. This statutory examination covers the period from January 1, 1998, to and including December 31, 2002, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

Work papers provided by the Company's independent auditor, KPMG, L.L.P., were reviewed and where deemed appropriate certain procedures and conclusions documented in those work papers have been relied upon and copied for inclusion into the working papers for this examination.

The previous examination of the Company was as of December 31, 1997. The Company was in compliance with all of the recommendations in that report.

This examination was conducted by Examiners from the North Dakota Insurance Department representing the Midwestern Zone.

HISTORY

General

The Company was incorporated on April 29, 1986, under the laws of the State of North Dakota. The Company's primary purpose is to engage in the business of property and casualty insurance. The Company is a wholly owned subsidiary of Nautilus Insurance Company; W. R. Berkley Corporation is the ultimate controlling person.

Capital Stock

The Company's Articles of Incorporation were amended by the shareholder on February 26, 1992, increasing the number of shares of stock authorized for issue from 2,500,000 to 6,000,000 with a par value of \$1 per share. At December 31, 2002, the Company had issued all 6,000,000 shares to its parent, Nautilus Insurance Company.

Dividends to Stockholders

During the period under examination, there were no dividends declared or paid.

Board of Directors

The Bylaws provide that the number of directors shall be not less than 7 nor more than 15. Directors shall be elected at the annual meeting of the stockholders and each director shall serve until his successor is elected and qualified.

Directors serving at December 31, 2002, were as follows:

Name and Address	Position With the Company and Business Affiliation
William R. Berkley, Jr. Greenwich, CT	Senior Vice President W.R. Berkley Corporation
Thomas Michael Kuzma Scottsdale, AZ	President & CEO Nautilus Insurance Company
John Runberg Scottsdale, AZ	Senior Vice President & Treasurer Nautilus Insurance Company
Eugene Ballard Greenwich, CT	Senior Vice President, CFO W.R. Berkley Corporation
Ira Seth Lederman Greenwich, CT	Sr. VP, Secretary, General Counsel W. R. Berkley Corporation
James S. Carey Cherry Hill, NJ	President & CEO Admiral Insurance Company
John M. DiBiasi Scottsdale, AZ	Executive Vice President Nautilus Insurance Company

Officers

The Bylaws provide that the elected officers of the Company shall be a President, a Secretary, a Vice President, and a Treasurer. The Board of Directors may also appoint other officers as may be reasonably necessary. Officers serving at December 31, 2002, were as follows:

<u>Officer</u>	<u>Title</u>
Thomas M. Kuzma	President and Chief Executive Officer
John M. DiBiasi	Executive Vice President
John M. Runberg	Treasurer and Senior Vice President
Philip J. See	Senior Vice President
Janet L. Shemanske	Secretary and Vice President
Ellen M. Hageman	Vice President
Anthony G. Howard	Vice President
Michael J. Kilgas	Vice President
Vickie L. Potts	Vice President
Cynthia A. Roa	Vice President

Conflict of Interest

The Company has an established procedure for the disclosure of possible conflicts of interest. Once a year, all directors, officers, and key employees are asked to complete and sign a conflict of interest questionnaire. The signed questionnaires are reviewed by the Company's Secretary. The conflict of interest statements for years under examination were reviewed and no conflicts were noted.

Corporate Records

The Bylaws and Articles of Incorporation and all amendments thereto were read by the Examiners.

At the January 10, 2002, meeting, the Board of Directors approved an amendment to Article IV of the Bylaws which removed the Chairman of the Board position from the list of required officer positions.

Board of Directors and Stockholders Meetings

The minutes of the Board of Directors, stockholders, and committee meetings for the period under examination were read and reviewed for compliance with the Bylaws, Articles of Incorporation and statutory requirements. The minutes reflected the elections of directors and officers, approvals of investment transactions and approvals of other pertinent matters requiring corporate review.

AFFILIATED COMPANIES

General

The Company is wholly owned by Nautilus Insurance Corporation, an Arizona corporation. The holding company structure as of December 31, 2002, is depicted in the following chart:

	<u>Jurisdiction of Incorporation</u>
Berkley International, LLC **	NY
Carolina Casualty Insurance Company	FL
Clermont Specialty Managers, Ltd.	NJ
J/I Holding Corporation	DE
Admiral Insurance Company	DE
Admiral Indemnity Company	DE
Berkley Risk Administrators Co., L.L.C.	MN
Nautilus Insurance Company	AZ
Great Divide Insurance Company	ND
Key Risk Management Services, Inc.	NC
Monitor Liability Managers, Inc.	DE
Monitor Surety Managers, Inc.	DE
Queen's Island Insurance Company, Ltd.	Bermuda
Signet Star Holdings, Inc.	DE

Berkley Insurance Company	DE
Berkley Regional Insurance Company	DE
Acadia Insurance Company	ME
Cadillac Mountain Ins. Co.	ME
Chesapeake Bay P&C Ins. Co.	ME
Berkley Insurance Company of the Carolinas	NC
Continental Western Insurance Company	IA
Continental Western Casualty Company	IA
Firemen's Ins. Co. of Washington, D.C.	DE
Great River Insurance Company	MS
Tri State Insurance Company of Minnesota	MN
Union Insurance Company	NE
Union Standard Insurance Company	OK
Facultative ReSources, Inc.	CT
Gemini Insurance Company	DE
Key Risk Insurance Company	NC
Midwest Employers Casualty Company	DE
Preferred Employers Ins. Co.	CA
Nonprofits Insurance Company	MN
Riverport Insurance Co. of California	CA
Signet Star Re, LLC	DE
StarNet Insurance Company	DE

W.R. Berkley Corporation, a Delaware corporation, owns 100% of the subsidiaries listed above except for Berkley International, LLC.

** W.R. Berkley Corporation and its subsidiaries have a 65% ownership interest composed as follows: W.R. Berkley Corporation (1%), Admiral Insurance Company (25%), Berkley Regional Insurance Company (10%), Nautilus Insurance Company (5%), and Berkley Insurance Company (24%).

INTERCOMPANY AGREEMENTS

Service Agreement

Effective March 1, 1993, the Company entered into a Service Agreement with its parent, Nautilus Insurance Company (Nautilus). Pursuant to this agreement, Nautilus agrees to furnish personnel and facilities in order to perform all accounting, underwriting, claims adjustment and payment, appointment and termination of producers, collection and handling of moneys, and various support services. The Agreement was amended in 1999 to provide for monthly reimbursement of loss and loss adjustment expenses by the Company to Nautilus. As a result of the Service Agreement, the Company has no employees, and all of its officers are officers of Nautilus or other W.R. Berkley Corporation affiliates.

Investment Advisory Agreement

Effective April 5, 1996, the Company entered into an Investment Advisory Agreement with Berkley Dean & Company whereby Berkley Dean & Company is appointed the Company's investment advisor and manager with authority to supervise and direct the investment and reinvestment of its securities in accordance with the Company's investment objectives. The securities under management by Berkley Dean and Company are held in a custodial account maintained by JPMorganChase pursuant to a Custodial Agreement with the Company.

Management Agreement

The Company entered into a Management Agreement dated September 23, 2003, with affiliate Berkley Underwriting Partners, LLC. The Agreement appoints Berkley Underwriters Partners as the Company's legal representative and lawful attorney for the purpose of producing, underwriting, and servicing specific commercial property and casualty business in Georgia, Massachusetts, and New Hampshire.

Consolidated Federal Income Tax Allocation Agreement

The Company entered into a Tax Allocation Agreement with W. R. Berkley Corporation on May 19, 1988, providing for the allocation of liability due to the consolidated federal income tax return of W. R. Berkley Corporation. On May 18, 1993, the Tax Allocation Agreement was amended to provide for an escrow account to be established and maintained by the parent in an amount equal to the excess of the amount paid by the Company to the parent for federal income taxes over the actual payment made by the parent. This account has not been established since no excess payments have been made to W. R. Berkley Corporation.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on a fidelity bond issued to its ultimate parent, W. R. Berkley Corporation. Other affiliated and non-insurance companies are also named insureds on the bond which provides coverage in the amount of \$15,000,000. The coverage meets the minimum amount of fidelity bond coverage recommended by the National Association of Insurance Commissioners for the Company and all of its affiliates. As the Company has no employees and holds no real or personal property, no other insurance coverage covering the Company is deemed necessary.

PENSION AND INSURANCE PLANS

The Company has no employees; therefore, it does not provide a pension or insurance plan.

STATUTORY DEPOSITS

The Company maintained the following deposits at December 31, 2002:

State	Type of Asset	Statement Value	Fair Value
Arkansas	Bond	\$ 309,944	\$ 392,782
Delaware	Bond	101,621	128,781
Georgia	Bond	86,378	109,463
Massachusetts	Bond	558,444	625,016
Mississippi	Bond	52,121	55,585
Nevada	Bond	208,486	222,340
New Mexico	Bond	315,192	344,625
Oklahoma	Bond	301,438	333,000
North Dakota	Bond	2,545,403	2,998,275
Total		<u>\$4,479,026</u>	<u>\$5,209,867</u>

The deposit with the State of North Dakota is held for the protection of all policyholders.

TERRITORY AND PLAN OF OPERATION

At December 31, 2002, the Company was licensed in the following states:

Alaska	Indiana	Nebraska	Rhode Island
Arkansas	Iowa	Nevada	South Carolina
California	Kansas	New Hampshire	South Dakota
Colorado	Kentucky	New Jersey	Tennessee
Connecticut	Maine	New Mexico	Texas
Delaware	Massachusetts	New York	Utah
Florida	Michigan	North Dakota	Vermont
Georgia	Minnesota	Ohio	Washington
Hawaii	Mississippi	Oklahoma	West Virginia
Idaho	Missouri	Oregon	Wisconsin
Illinois	Montana	Pennsylvania	Wyoming

The Company writes business in Arizona, North Carolina, and Virginia on an excess and surplus lines basis.

The Company's business is solicited through 48 agents. These agents write business and issue policies in accordance with the underwriting authority granted by the Company. The Company's primary lines of business in 2002 were Other Liability and Fire.

REINSURANCE

Ceded

The Company ceded reinsurance premiums totaling \$28,209,269 in 2002 and as of December 31, 2002, had losses and loss adjustment expense reserve credits for ceded business totaling \$37,420,000. Of the reinsurance premiums ceded, \$987,497 represented reinsurance premiums for a fronting arrangement with affiliate, Fireman's Insurance Company of Washington, D.C., Presque Isle Division and \$158,193 for a fronting arrangement with affiliate, Berkley Insurance Company. The remaining reinsurance ceded premiums represented all other business written by the Company which is 100% ceded to its parent, Nautilus Insurance Company ("Nautilus").

The following is a summary of the significant reinsurance agreements in effect at December 31, 2002:

Type:	Quota Share
Reinsurer:	Presque Isle Division of Firemen's Insurance Company of Washington, D.C.
Scope:	All lines of business
Coverage:	All limits written
Premium:	100%
Commissions:	Reimbursement equal to commissions, premium taxes and assessments paid by the Company and a fee ranging from 0.1% to 3.0%.
Termination:	Either party may cancel by providing not less than 90 days written notice.
Type:	Ceding and Retrocession
Reinsurer:	Nautilus Insurance Company
Scope:	All lines of business
Coverage:	All limits written
Premium:	100%
Commissions:	Reimbursement equal to commissions, premium taxes and assessments paid by the Company.
Termination:	Either party may cancel by providing not less than 90 days written notice.

With the exception of business written pursuant to the fronting agreements with the Presque Isle Division and Berkley Insurance Company, the Company cedes 100% of its business to Nautilus which in turn cedes that business to nonaffiliated reinsurers in accordance with a series of quota share, excess loss, and facultative treaties. Nautilus then retrocedes back to the Company a portion of business it retains under those treaties. During the period under examination, the retrocession percentages applied to Nautilus' net retention was as follows:

	<u>1998- 2002</u>
Property and casualty lines	68%
Transportation line	36%

At December 31, 2002, the reinsurance credits taken by the Company for unpaid losses and unearned premiums agreed with the assumed payables reported by the Company's parent, Nautilus Insurance Company, in its 2002 Annual Statement, Schedule F.

All significant reinsurance agreements contained an insolvency clause as required by N.D. Cent. Code § 26.1-02-21.

ACCOUNTS AND RECORDS

The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the course of the examination and a trial balance as of December 31, 2002, was extracted from the general ledger and traced to the appropriate schedules of the Company's 2002 Annual Statement. The Company's ledgers are maintained electronically. Revenues and expenses were test checked to the extent deemed necessary.

The Company is audited annually by an outside firm of independent certified public accountants, as a part of the audit of W. R. Berkley Corporation. The work papers of this firm were made available to the Examiners and were used to the extent deemed appropriate for this examination.

FINANCIAL STATEMENTS

The financial statements of the Company are presented on the following pages in the sequence listed below:

Statement of Assets, Liabilities, Surplus, and Other Funds, December 31, 2002
Underwriting and Investment Exhibit, Year 2002
Reconciliation of Capital and Surplus, January 1, 1998 through December 31, 2002

Great Divide Insurance Company
Statement of Assets, Liabilities, Surplus, and Other Funds
as of December 31, 2002

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$46,367,422		\$46,367,422
Stocks:			
Preferred Stocks	2,257,500		2,257,500
Cash	1,037,860		1,037,860
Short-Term Investments	2,025,607		2,025,607
Agents' Balances or Uncollected Premiums:			
Premiums and Agents' Balance in Course of Collection	2,993,547	\$23,799	2,969,748
Reinsurance Recoverables on Loss and Loss Adjustment Expense Payments	628,263		628,263
Federal Income Tax Recoverable	780,736		780,736
Guaranty Funds Receivable or on Deposit	174,200		174,200
Interest, Dividends, and Real Estate Income Due and Accrued	761,016		761,016
Totals	<u>\$57,026,152</u>	<u>\$23,799</u>	<u>\$57,002,353</u>

Great Divide Insurance Company
Statement of Assets, Liabilities, Surplus, and Other Funds
as of December 31, 2002

Losses		\$ 11,190,788
Reinsurance Payable on Paid Loss and LAE		319,808
Loss Adjustment Expenses		4,298,889
Commissions Payable, Contingent Commissions and Other		2,534,440
Similar Charges		
Other Expenses		47,098
Taxes, Licenses, and Fees		149,030
Federal Income Taxes		1,196,723
Unearned Premiums		7,280,053
Ceded Reinsurance Premiums Payable		1,361,437
Payable to Parent, Subsidiaries, and Affiliates		<u>226,976</u>
 Total Liabilities		 \$28,605,243
 Common Capital Stock	\$ 6,000,000	
Gross Paid In and Contributed Surplus	11,895,749	
Unassigned Funds (Surplus)	<u>10,501,362</u>	
 Surplus as Regards Policyholders		 <u>28,397,111</u>
 Total		 <u><u>\$57,002,353</u></u>

**Great Divide Insurance Company
Underwriting and Investment Exhibit
for the Year Ended December 31, 2002**

UNDERWRITING INCOME

Premiums Earned		\$16,138,077
Deductions:		
Losses Incurred	\$5,945,233	
Loss Expenses Incurred	2,090,645	
Other Underwriting Expenses Incurred	<u>5,114,868</u>	
Total Underwriting Deductions		<u>13,150,746</u>
Net Underwriting Gain or (Loss)		\$ 2,987,331

INVESTMENT INCOME

Net Investment Income Earned	\$2,584,143	
Net Realized Capital Gains or Losses	<u>935,028</u>	
Net Investment Gain or (Loss)		3,519,171

OTHER INCOME

Net Gain (Loss) From Agents' Balances Charged Off	<u>\$ 46,151</u>	
Total Other Income		<u>46,151</u>
Net Income Before Federal Income Taxes		\$6,552,653
Federal Income Taxes Incurred		<u>2,254,129</u>
Net Income		<u>\$4,298,524</u>

Great Divide Insurance Company
Reconciliation of Capital and Surplus Accounts
January 1, 1998, through December 31, 2002

	For Years Ending				
	2002	2001	2000	1999	1998
Capital and Surplus, December 31, Previous Year	\$23,877,137	\$21,072,629	\$19,359,115	\$17,634,066	\$16,870,653
Net Income	\$ 4,298,524	\$1,986,513	\$1,919,322	\$1,717,029	\$753,531
Net Unrealized Capital Gains or (Losses)	76,700	200,000	(200,000)		
Change in Net Deferred Income Tax	115,697	131,841			
Change in Nonadmitted Assets	29,053	(47,044)	(5,808)	8,020	9,882
Cumulative Effect of Changes in Accounting Principles		533,198			
Net Change in Capital and Surplus for the Year	\$4,519,974	\$2,804,508	\$1,713,514	\$1,725,049	\$763,413
Capital and Surplus, December 31, Current Year	\$28,397,111	\$23,877,137	\$21,072,629	\$19,359,115	\$17,634,066

COMMENTS ON FINANCIAL STATEMENTS

Federal Income Tax Recoverable

The Tax Allocation Agreement between the Company and W.R. Berkley Corp., amended paragraph 3, states: "At the end of each quarter, Subsidiary shall calculate its actual tax liability for the quarter and, after giving effect to estimated tax payments, shall pay Berkley any balance due within 45 days after the end of such quarter." In 2002, a single federal tax payment of \$1,575,000 was transferred to WR Berkley Corp. on August 21, 2002, rather than the quarterly settlements stated in the Tax Allocation Agreement. **It is recommended that the Company comply with the quarterly settlement provision in its affiliated Tax Allocation Agreement.**

The Examiners noted the following reporting differences in the 2002 Annual Statement:

- The Company did not net the portion of DTA/DTL changes allocable to unrealized gains/losses against the related change in unrealized gains and losses reported on page 4, line 23, as required by SSAP No. 10.
- The Company did not include the change in nonadmitted DTAs in the amount reported on page 4, line 26, Change in Non-admitted Assets, as required by SSAP No. 10.

It is recommended that the Company report deferred taxes in compliance with the guidance contained in Exhibit A of SSAP No. 10.

Losses and Loss Adjustment Expenses

This examination projected the Company's reserves for net unpaid losses using the following methods: paid loss development, incurred loss development, and Bornhuetter/Ferguson. The loss development factors were based on the Company's direct and net data, and Nautilus' net indications, adjusted by re-adding in the Company's net data. The Nautilus data reflects the impact of reinsurance arrangements that ultimately impact the Company's net business.

This examination projected the Company's outstanding Adjusting and Other expense liability by relying on the traditional paid Adjusting and Other to paid loss relationship.

The reserve review found the loss and loss adjustment expense reserves were adequate on a net basis.

Underlying data was tested by the examiners with no differences noted.

CONCLUSION

The financial condition of the Company, as of December 31, 2002, as determined by this examination is summarized as follows:

Admitted Assets		<u>\$57,002,353</u>
Total Liabilities	\$28,605,243	
Surplus as Regards Policyholders	<u>28,397,111</u>	
Liabilities, Surplus, and Other Funds		<u>\$57,002,353</u>

No change was made in the amounts reported by the Company in its 2002 Annual Statement.

Since the last examination conducted as of December 31, 1997, the Company's admitted assets have increased \$25,254,516, its total liabilities have increased \$13,728,058, and its surplus as regards policyholders has increased \$11,526,459.

The courteous cooperation extended by the officers of the Company and the employees of the Nautilus Insurance Company during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Mike Andring, ACAS of the North Dakota Insurance Department, Carole Kessel, CPA and Chief Examiner, and Rhoda Sautner, CPA participated in this examination.

Respectfully submitted,

David Weiss, CFE
Examiner
North Dakota Insurance Department

COMMENTS AND RECOMMENDATIONS

It is recommended that the Company comply with the quarterly settlement provision in its affiliated Tax Allocation Agreement.

It is recommended that the Company report deferred taxes in compliance with the guidance contained in Exhibit A of SSAP No. 10.